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U.S. Congress. House.

Amendment of section 501
of the Transportation Act...

Washington

1921

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AMENDMENT OF SECTION 501 OF THE TRANSPORTATION ACT
AFFECTING SECTION 10 OF THE CLAYTON ACT

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HEARING

BEFORE THE

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COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
OF THE HOUSE OF REPRESENTATIVES

SIXTY-SIXTH CONGRESS

THIRD SESSION

ON

H. R. 14674

DECEMBER 14, 1920



WASHINGTON
GOVERNMENT PRINTING OFFICE
1921

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE.

HOUSE OF REPRESENTATIVES.

SIXTY-SIXTH CONGRESS.

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AMENDMENT OF SECTION 501 OF THE TRANSPORTATION ACT,
AFFECTING SECTION 10 OF THE CLAYTON ACT.

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
HOUSE OF REPRESENTATIVES,
Tuesday, December 14, 1920.

The committee met at 11 o'clock this morning, with Hon. John J. Esch, chairman, presiding.

The CHAIRMAN. We are called together this morning to consider H. R. 14674, a bill to amend section 501 of the transportation act, 1920. Who desires to be heard this morning?

Mr. Thom arose and addressed the committee.

STATEMENT OF MR. ALFRED P. THOM, OF WASHINGTON, D. C.,
REPRESENTING THE ASSOCIATION OF RAILWAY EXECUTIVES.

Mr. THOM. Mr. Chairman and gentlemen, it perhaps would be useful to explain that this section—section 10 of the Clayton Act—has been several times considered by Congress and the effective date of it has several times been extended. That was due to a conviction on the part of Congress.

Mr. MERRITT. What is section 10 of the Clayton Act?

Mr. THOM. The section requires common carriers to take bids on their purchases and on their issues of securities if there is on the board of the common carrier, or as its general manager, or its purchasing agent or agent for the particular transaction a person having a representation also on the selling or other company with which the dealing is. I will read that in a few moments. That is the general subject of the section. These postponements have been due to a conviction on the part of Congress entertained by both branches that there were certain things about section 10 that ought to be considered more maturely, and that it ought to be amended. The carriers directly interested with these difficulties about the section have been before Congress all these years attempting to get a hearing on the subject of the amendment. The convenience of Congress has never permitted that consideration.

The CHAIRMAN. That was not the fault of this committee. Our committee didn't have jurisdiction of the Clayton Act.

Mr. THOM. I am not referring to that. I refer to Congress. The matter has been argued before the Judiciary Committee of the House, and it has been argued before the Judiciary Committee of the Senate, and the result was postponement so as to give adequate consideration. Last spring an effort was made to have an amendment dealing with this subject put into the transportation act, but

likewise, in view of the tremendous problems which the committees and Congress were obliged to confront in that legislation, it was considered that time could not be profitably expended in the consideration of this section. The result was that the matter was dealt with by section 501 of the transportation act in extending the effective date so as to give Congress still another chance to deal with this subject. That was followed at once by the introduction into the Senate of bills amending section 10 of the Clayton Act, or if they were not actually introduced they were prepared and placed in the hands of one of the Senators whose desire it was to introduce them. That was Senator Kellogg. He at once referred those bills to the Interstate Commerce Commission for its judgment upon their merits and its recommendation in respect to that matter, the hope being that the report from the Interstate Commerce Commission would be received in time for Congress to act before its adjournment. You gentlemen, perhaps more fully than any other body of men except the similar body in the Senate, can appreciate the tremendous load of responsibility that was placed upon the Interstate Commerce Commission by the new legislation and the absolute engrossment of their time in the consideration of the problems that were committed to them. In that tremendous load of work and responsibility it seems that this reference was forgotten, and when I recently went to try and find out what had been the fate of that reference I was told that no such communication had ever been received. Finally, however, it was discovered that that was a mistake; the communication had been received, it had been referred to the law officer for report, the report had come in and was in the files, but the commissioner to whom it was referred, having to devote his time to other and more engrossing subjects, had simply overlooked that, and nothing had been done. Consequently, Congress adjourned without the matter ever having been brought up for its consideration.

Now, section 501 only extends the effective date of the section till January 1 next. Manifestly Congress has not the time now between now and January 1 to consider this subsection on its merits and to determine what the proper legislation is. The Interstate Commerce Commission I am sure realizes, and if I am not mistaken (if I am, the chairman can correct me), there is in the hands of the chairman now from the Interstate Commerce Commission a letter favoring the postponement and intimating that it is necessary, in order that this policy may be workable, that the section shall be considered again by Congress and properly amended.

It is my desire by that brief statement to indicate that there has been no lack of diligence on the part of the carriers in their efforts to bring this matter properly before the committee of Congress.

With that preamble, Mr. Chairman, I would like to read this section and to give the committee an idea of what we find are the grave problems that are presented by it. Section 10, or that part of it which is necessary for me to ask your attention to in order that you may understand what I have to say on the subject, is as follows:

That after two years from the approval of this act no common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for construction or maintenance of any kind to the amount of more than \$50,000 in the aggregate in any one

year with another corporation, firm, partnership or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer or agent in the particular transaction any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in such other corporation, firm, partnership, or association, unless and except such purchases shall be made from or such dealings shall be with the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission. No bid shall be received unless the name and address of the bidder or the names and addresses of the directors, officers, and general manager thereof if the bidder be a corporation or the members of it be a partnership or firm shall be given with the bid.

Then, that is followed by the penalty clauses. Of course, I suppose it is a matter of common knowledge that competitive bidding is about the most costly way of buying. The Government buys by competitive bidding, cities and counties buy by competitive bidding, and it is commonly known that they pay very high prices and are subjected to all sorts of combinations of bidders, so that in itself, unaccompanied by other conditions and without reference to other objects to be attained, no one, I suppose, would regard competitive bidding as a desirable way of purchasing. I may say in passing that it is in the evidence which I have here that one of the most responsible representatives of the purchasing department of these carriers, Mr. Henry B. Spencer, formerly vice president of the Southern Railroad, testified that out of \$7,000,000 of purchases a year, if the purchasing had to be done by competitive bidding, the road would lose at least \$1,000,000—would be more expensive by \$1,000,000. Bearing that in mind, I wish to call your attention to some of the things that are involved in this law as it is now written. And this is said, Mr. Chairman, without in any way assailing the principle on which this law is written. The principle on which this section stands is that the seller and the buyer shall not be the same; that the seller and the buyer shall not have a fiduciary relation and an individual temptation for a private advantage at the same time, and I am not assailing that proposition. What we are asking is an amendment of this section.

Now, the first matter to which I call your attention is that the law, as it now stands, provides that there shall not be purchased under the conditions mentioned in section 1 amounting to as much as \$50,000 in the aggregate in any one year without competitive bidding. Suppose a purchase of \$5,000 is made in January. The question whether or not that purchase must be made by competitive bidding will depend on whether or not there are additional purchases made during the remaining 12 months of the year which, in the aggregate, will be as much as \$50,000. That can't be known in January. So that the limitation of \$50,000 which Congress has placed upon this is no limitation. You would have to begin the first purchase you made of \$100 or \$5,000 and put it out to bid, for the reason that before the end of the year you may find yourself in violation of the statute if you happen to buy more than \$50,000 from the same seller. So that the law, as it stands now, absolutely commits the carriers, under a construction of the acts, which is by no means unlikely, to making all their purchases under this plan of competitive bidding.

In addition to that, as a means of showing that the result of the act as written is that all purchases must in practice be made by competitive bids, it is provided that if any of the officers of the carrier mentioned have a substantial interest in the selling company, etc., the purchases must be made under the statutory method of competitive bidding.

How are you to determine what the interest of the individual officer is in the selling company? The stocks and securities of these selling companies are on the market. A man who is not interested one day is interested the next, because he buys in. It is impossible, by inquiry in advance, to find out what the interest of one of these officers will be next week, and as a consequence what is the carrier to do? Is it to take the chance of the officers not having become interested and to take the chance of buying without bidding and thus of violating the law? Or is it, in the first instance, to act on the safe side and do all its purchasing by this extravagant method of competitive bid?

Another question arises as to what is a substantial interest. I have before me here a letter from the general counsel of the Union Pacific, which undertook to find out by a circular to all its directors what interest they had in certain other companies with which they were dealing. Some of them said we have got only a trivial interest. How do we know whether it is a trivial interest or not? What is a trivial interest? What is a substantial interest? One man said he had 300 shares in one of these selling companies. That was a very small part of the aggregate amount of the stock of that company; but did it bring him within the purview of this law that he should not have an interest on both sides of the transaction? We think we have drawn a bill which will give some sort of opportunity to have defined what is a substantial interest. As the law is at present there may be no safe course but for the carriers to start in and do their buying under the principle of competitive bidding with all its wastefulness and with all of its unnecessary cost.

Then, if a carrier wants to buy an article of a seller where there is only one seller at the place of delivery, he must, under this law, ask for bids nevertheless.

THE CHAIRMAN. Suppose a man had a patented article?

MR. THOM. I am coming to that in a moment. But take for instance a railroad that wants to buy water, or gas, or electricity, or ice along its line and where there is only one company at the point that can deliver it, that can make a sale. Under this law, you are obliged to advertise, notwithstanding the fact that your advertisements will mean nothing.

Take the incident of the patented article referred to by the chairman the article can be furnished by only one concern and yet there must be bidding. Take the matter of the article that is manufactured by secret processes, and there are a great number of them. There must be bidding, and yet the secret process that is the most valuable may be controlled only by a single individual. I wish to read you some testimony as to what that has meant. Some time ago it was the desire of one of the great railroad systems of this country to buy an axle of special strength, and it made an investigation to find out the processes which were most reliable in respect to the pro-

duction of the axle of the desired strength. Mr. Spencer, in testifying on that subject, gave this testimony:

MR. SPENCER. Various manufacturers work out the processes and usually try to keep them secret. In some cases they patent them. In others, where the patenting of them would give them publicity, they do not patent them. That is especially true of a great many of the chemical combinations and the paint combinations, and it is very largely true in a great deal of metal working, such as steel or the special bronzes, etc. These manufacturers, as a rule, endeavor to keep their processes secret from the public and from their own organizations, so that you can not find out exactly what they are doing to accomplish their final result.

And again he said:

MR. THOM. Did you ever have any experience in buying axles for passenger cars which illustrate this last point?

MR. SPENCER. Yes; quite a serious case, too. We decided with the new steel car, steel passenger equipment, that it was necessary to have an axle with a higher tensile strength than we heretofore had, so we decided to go into heat-treated axles, that being practically the only steel where we would get what we believed was the stronger axle.

There were about four concerns in this country that were making heat-treated axles. We asked them for competitive bids. We had our superintendent of tests go into the matter pretty fully, and then we selected the best one, as we believed. At that time we selected the lowest priced one with a view of getting economy. It took about six months for those axles to be delivered and put into service. The cars had been in service, the first cars, about three days when they had a broken axle. In about 48 hours we had another car with a broken axle. We were thoroughly alarmed, of course. Fortunately there was no serious accident, but the possibilities of it were there. So we then began to investigate the causes of that, and we found that in this heat treating some internal flaws developed. We called the attention of the manufacturer to that, and he explained that that was the first he had of that kind; but we went further, and we found that his process would develop those flaws. They were not apparent externally at all and only developed after the car was in service, although a vibratory test had been made of the material. The flaws did not show up in that way, so evidently we could not duplicate the service of an axle on a machine that it gets in actual service, and we had to very promptly abandon all of these axles and took them out just as quickly as we could. Then we tried another manufacturer, because it was necessary to have high-tensile steel. We got the steel from the other manufacturer through his process, which is secret and not patented, as we understand it, and we have had no further trouble. His method avoids those flaws, whereas the other concern had the flaws in their method.

MR. THOM. In other words, in the interest of safety, Mr. Spencer, it is important for the carrier to have the right of selection between makers.

MR. SPENCER. I think it is absolutely essential, Mr. Thom.

MR. THOM. And although the bid may not have been the lowest, and though in that case you thought you had done everything to safeguard safety, it proved that you had not, and that the other maker, by his secret process, produced a satisfactory article to which you had ultimately to go.

MR. SPENCER. Yes.

MR. THOM. Now, of course, in any accident that occurred the carrier had imposed upon it both the moral and the financial responsibility for the accident?

MR. SPENCER. Absolutely, sir.

MR. THOM. On the one hand, and if, on the other, the question of the discretion of the carrier was a matter for some other tribunal to determine, the carrier would be obliged to fight it out with the man who had made the complaint that he had given the most favorable bid.

MR. SPENCER. Yes, sir.

MR. THOM. And you had tried this theoretical method in your selection of the first axle and it had failed, and you were obliged afterwards to go to the practical basis of selecting some other manufacturer's article?

MR. SPENCER. Yes.

And he goes on to say that it is necessary to protect the life and property of the public according to the judgment of men and the experience of men with respect to the various articles which are purchased, and competitive bidding may bring in a low bid from somebody that hasn't got the best process.

Mr. DEXTER. Where was that testimony given?

Mr. THOM. That testimony was given before the Interstate Commerce Commission when we were seeking to have them formulate rules under this section 10. We had an elaborate hearing and this testimony was given there to indicate the difficulties.

Another one of the difficulties we have is that here is a railroad that has adopted its own standards of equipment for safety, for comfort, for economy, and it is necessary in the interest of the public that those standards should be maintained and those standards can only be gotten from a single maker; yet there, under this law must be competitive bidding, and railroad standards must be abandoned.

Then it is provided that in the competitive bidding the railroad must accept the bid that is most favorable to it. There is no standard in the act of what is most favorable to it. We ask that the standard shall be made the exercise of an honest business discretion without reference to the promotion of the interest of any person in the transaction. Now, suppose there is no such standard of honest business discretion but the requirement is that the most favorable bid shall be adopted. The experience of all you gentlemen will inform you at once of the probability—I may say the certainty—that as soon as this system of unqualified and mandatory public bidding is adopted, there will be developed in the business world an array of adventurers who will seek to put in the lowest bid, to have it accepted by force of the law and to sell it to somebody else. If the carriers can not have the protection of the exercise of an honest business discretion, as soon as they reject one of these bids the harpies that will seek to fasten themselves on these carriers, and consequently fasten themselves on the public, will at once say that the lower bid was rejected, and the question of what is most favorable will be a question for a court and jury, and the litigation that will be created by that system will be not only enormous but will be destructive of the efficiency of the operation of the carriers.

Mr. COOPER. Do I understand, Mr. Thom, that this law compels the carrier to accept those bids regardless of the quality?

Mr. THOM. It requires them to accept the most favorable bid; and, of course, unless the carrier can have a business discretion as to these things that you are talking about—an honest business discretion—then the lowest bidder will say, "This is the most favorable bid, and you have violated the law in not accepting it," and will bring a suit against us because we didn't accept the bid, on the allegation that his bid was the most favorable. When this is done, the whole control of the management of these properties will be transferred from the purchasing department and put before the courts and juries of the country.

I shall not undertake at this time to discuss this matter in full, because I shall hope for an opportunity of discussing what ought to be done about it when we come before you under the bill proposing an amendment. I am seeking now merely to point out some of the

reasons which would justify an inquiry on your part as to what is best for the public interest in respect to this important matter.

Another thing I want to call your attention to. Take the Ohio floods. Put a carrier in the midst of that ruin. Necessarily, to build bridges and to restore track and to resume its transportation duties, a great deal of emergency buying will be necessary in such a case as that. It is impossible to deal with such a situation as that by competitive bids, and it seems to me that it would be wise on the part of Congress in its legislation to require the Interstate Commerce Commission or to empower them to permit purchases in such emergency as that without competitive bidding.

But that is not the only kind of emergency that may arise. Here is a New England situation in respect to fuel. The testimony of one of the New England purchasing agents is here before me. It shows that, in case of an inadequate supply in that section of the country—and of course what I am saying now is of more or less general application—it is necessary for them to pick up fuel wherever they can get it, and get it quickly, or the engines will stop running. This purchasing agent of the New England road illustrates by a case where the only man that had any fuel that was available for their engines happened to have some relation with the company, and if this law had been in effect the road couldn't, during that emergency, buy any fuel to keep its engines running, because of an interest on the part of this man, regardless of how honest the transaction was or how necessary it was to be carried through.

Mr. JONES. I happen to know of the law in New York State requiring the railroads to burn oil certain months of the year. How would it affect them if this law was operative?

Mr. THOM. It would depend upon the supply. If they could foresee all their needs and could have time for all these bids to be put out, they might manage it; but if they got to a place where it would be short and had to get oil anywhere they could get it, why, it would be impossible for them under this law to get it and make the emergency purchase in order to carry on their transactions, with the law written as it is, unless it is modified by conference rulings, without any authority for such conference rulings on the face of the act itself.

Mr. SIMS. We have been extending by similar resolution the effective date of this act for several years, haven't we? For one year at a time?

Mr. THOM. Yes, sir.

Mr. SIMS. In view of that, wouldn't it be wise to make this two years instead of one?

Mr. THOM. It has been suggested to us by a gentleman in the Government service here that we had better make the limit of the extension coincident with the provisions of the transportation act about interlocking directorates, which takes effect after the 31st of December, 1921. You gentlemen have an opportunity to act during this session of Congress, and during the special session of Congress, and we hope you will be able to act on it in that time.

Mr. SIMS. But to prevent any conflict in that regard, that is the reason, Mr. Thom?

Mr. THOM. Yes, sir.

Mr. SIMS. I thought it would be a good idea to make it two years if general legislation is to be had before it is to be effective. I really know but little about it.

Mr. RAYBURN. You have prepared a bill, have you not?

Mr. THOM. Yes, sir; and it has been introduced.

Mr. MONTAGUE. In reply to Mr. Jones, you stated that a conference ruling might be necessary. What do you mean by a conference ruling?

Mr. THOM. I meant by that the Interstate Commerce Commission has been in the habit, under the interstate-commerce law, of making conference rulings as to the meaning of the law. We have been attempting to get a conference ruling in these hearings but we have failed. They haven't seen fit to make a conference ruling, as we asked them to make, and that was the meaning of my answer to Mr. Jones. If we could get a satisfactory conference ruling we would be pretty safe.

Mr. JONES. In that State where they burn fuel under State law, the Public Service Commission of the State of New York on 12 hours notice can compel them to burn oil, what position would they be in?

Mr. THOM. They would be in position to have to buy that by competitive bidding, and you will see the complications that would arise.

Mr. COOPER. Hasn't it been the practice in the past, with a large railroad system where they had several branches, to buy from one another where they had excesses?

Mr. THOM. Yes, sir; and I am coming now to that point. Perhaps the most important thing, I think, you gentlemen see already in this law sufficient reasons to justify your mature consideration of its requirements; but I am coming now to the most important consideration, perhaps, of all, and that is to the relation between a common carrier and its subsidiaries and its branch lines. Mr. Rayburn will tell you that there is a law of Texas that a railroad operating in Texas must operate under a Texas charter. Isn't that so, Mr. Rayburn?

Mr. RAYBURN. Yes, sir.

Mr. THOM. A foreign corporation can not operate through Texas. Texas is illustrative, as I understand it, of some other States. Many of the most important systems in the country operate through Texas—the Southern Pacific, the Atchison, and others. The public thinks it is riding on the Southern Pacific or the Atchison from the Mississippi River to California. The fact is that they are riding up to the Texas border on the lines of one company; they pass through Texas on the lines of another company; and they take up at the other Texas line the lines of the first company and go on to their destination. It is most important for the public interest that those systems shall not be broken up; that they shall be operated harmoniously as one system.

As a consequence, the method adopted is to have the officers of the main company also officers of the Texas company, so that there may be uniform policies, harmonious operation, and system operation. Well, the way that one of those subsidiaries is financed is generally this: The money necessary to make the improvements in the State

of Texas is furnished by the parent company, and then the securities of the subsidiary in Texas are issued and taken into the treasury of the parent company and ultimately sold to reimburse the treasury of the parent company. That transaction would not be possible under this law, because the securities of this Texas company must be put up at auction or disposed of by public bidding, and if bought by an outsider the continuity of the system would be destroyed.

Mr. JONES. Do I understand that section 10 refers to securities as well as operating supplies?

Mr. THOM. Yes, sir; and under it it would be impossible to hold these railroads together. Your system would be gone. But what are you going to say as to that in view of the policy of this act which is in favor of consolidation of the systems? Are you going to have a law on your books here which breaks up all your systems at the same time that you have a law which says you must consolidate or ought to consolidate whenever sound public policy would be promoted?

Mr. SIMS. In that respect, does the transportation act repeal so much of section 10 as affects this matter?

Mr. THOM. That is not the language of the transportation act. It is the working of it.

I will take the Union Pacific system. From Omaha to the Pacific coast it is made up of the Union Pacific Railroad, the Oregon Short Line, and the Oregon & Washington Navigation Co.—three corporations. They are under one management, under one system, so far as the traveling and shipping public knows, but exactly the same thing that I have illustrated about the State of Texas occurs in respect to those railroads. The Union Pacific Railroad is the company that furnishes the Oregon Short Line and the Oregon & Washington Navigation Co. financial ability to keep them up. Their securities are taken by the parent company for its advances and are then put upon the market when the market will take them.

Mr. SIMS. Doesn't the New York Central own the Oregon Short Line?

Mr. THOM. No; the New York Central doesn't go beyond the Mississippi River.

Mr. SIMS. Doesn't it own a majority of the stock?

Mr. THOM. No. The Union Pacific owns it. I am going to read you in a few minutes a description of the situation of the Southern Pacific, of the Pennsylvania, of the New York Central, and of the Atchison in respect to these matters; but before doing that I wish to advert to another valuable practice suggested by Mr. Cooper's question. It is the practice of these large systems to buy by wholesale and parcel out to the subsidiaries what they need in the way of materials and supplies at the prices at which the parent company buys plus transportation, or on similar terms. I am told that there have been some abuses in connection with that practice and that legislation ought to deal with the price at which the supplies may be charged out. But, manifestly, it can be advantageously arranged by a requirement of purchases by public bids. Manifestly, the whole transaction will be made impossible if the purchases must be made by bids. If the legislation can prescribe a price at which this charging out shall be done or beyond which it shall not go, it may be very well. In fact, I have embodied in the draft which I have submitted

to Congress a limit of the price at which the supplies may be charged out.

Mr. JONES. You mean in dollars and cents?

Mr. THOM. No; the purchase price plus transportation. So that all the useful means of holding these great systems together, by which economies are practiced, by which their business is facilitated, will be destroyed unless there is more elasticity given than is given in this act. Now, I said to you that I would read certain statements in respect to these particular matters. I read first from a statement of the Southern Pacific:

The Southern Pacific system is a typical example of a system of connecting lines held together by stock ownership so as to form a long through connecting line under unified management and control. It extends from Portland, Oreg., to two terminals on the Gulf of Mexico—New Orleans and Galveston. The major part of this line was constructed as a system of connecting lines; a minor part, from San Antonio to the Gulf, was acquired, to connect with the constructed part, by purchase of the stock of several small local connecting railroad companies in Texas and New Orleans. The whole was connected up and completed more than 30 years ago. It was conceived, constructed, and acquired and has ever since been operated as a connecting system of lines under one ownership. The Southern Pacific Co. owns all the stock of the constituent companies and has always been their financial sponsor. The roads west of El Paso are operated by the Southern Pacific Co. under leases, this being permitted by the laws of the States traversed by the roads. The laws of Texas and Louisiana require that the roads in those States should be operated by the corporations owning them; hence the system east of El Paso, composed of several connecting railroads, is operated in the names of the several corporations of Texas and Louisiana which own them. The Southern Pacific Co. owns all the stock of these corporations; the unity of management essential to the efficiency of the through line is effected by the local corporations having common officers. These short roads are largely dependent upon the parent company, the Southern Pacific Co., for financial assistance. It advances the money needed for betterments and additions, and from time to time takes notes or other securities to cover such advances. In order to secure economy as well as efficiency in the operation of these several local roads, they have constant dealings with each other in the matter of supplies, equipment, maintenance, etc.

The above description of the Southern Pacific system has been given for the purpose of showing that, composed as it is of connecting lines, it is such a system as is expressly and impliedly authorized by section 7 of the Clayton Act. Indeed, such a system of connecting lines is not condemned by the laws or public policy of any State. The reason why the formation of such a system through stock ownership of a parent company has not been condemned but encouraged is because a through connecting line under one control is of manifest advantage, and because it is rarely possible, by reason of the policy or laws of the different States, to secure a common control of an interstate line by common ownership of the physical property.

The advantage of common control and management of a system of connecting lines by a parent company is efficiency and economy in management resulting from common officers and from financial aid afforded from time to time by the parent company. It is, of course, impossible to operate a system of connecting lines without common officers, and it is equally impossible to have system operation without constant dealings between the parent company and the subsidiary lines, and between the different subsidiary companies, in respect to securities, supplies, and construction and maintenance.

Now, then, the effect of section 10 of the Clayton Act—

if construed as covering transactions between a company and its subsidiaries—

as applied to the Southern Pacific system, is to prevent the Southern Pacific Co. and the subsidiary companies, all of whose stock it owns, either from having any common directors or managing officers or from having any dealings with each other in respect to securities, supplies or other articles of commerce, or arrangements relating to construction and maintenance.

Now, as to the Pennsylvania Road, here is a letter written by the purchasing agent of the Pennsylvania Railroad to one of its vice presidents:

So far as providing material and supplies is concerned the intercorporate relations of the Pennsylvania Railroad Co. consist of furnishing on order and material sheet to its subsidiary or affiliated companies, or vice versa, materials for the operation of various railroads, viz., Pennsylvania Lines West; Philadelphia, Baltimore & Washington Railroad Co.; West Jersey & Seashore Railroad Co.; New York, Philadelphia & Norfolk Railroad Co.; the Washington Terminal Co.; Cumberland Valley Railroad Co.; Cornwall & Lebanon Railroad Co.; Susquehanna, Bloomsburg & Berwick Railroad Co.; Baltimore, Chesapeake & Atlantic Railroad Co.; and the Maryland, Delaware & Virginia Railroad Co.; also the building of new locomotives, freight and passenger car and other equipment for these allied interests; in addition the purchase of anthracite coal on a competitive basis from the Susquehanna Coal Co.

The material may be such as is manufactured at our own shops and standard for locomotive, car, and track repairs, etc., common for use of all companies, which is carried in stock at a central point for distribution as needed, or it may be stock lying idle or surplus at one point and badly needed elsewhere, which is transferred from one company to another.

The advantage of this practice is apparent in that it enables us to purchase in larger quantities at the lowest prices, safeguards the supply, provides intelligent regulation of stock balances; also the carrying of minimum quantities at the small shops and in many instances obviates the purchase of new material in times when business becomes less active. Furthermore, in view of our equipment being standard for practically all affiliated companies it is decidedly advantageous in maintaining efficient service and saving in time to supply repair parts and certain supplies from our own shops where we already have facilities and necessary machinery, patterns, dies, etc., for manufacturing the material promptly and economically, as required for the needs of the service, thereby aiding in assuring operation at maximum efficiency and capacity independent of individual commercial industry which at the present time is either entirely inadequate to meet present demands or is finding a more attractive market elsewhere for its production.

It is our practice in making arrangements for materials, both for new work and repairs, by contract or otherwise, to include the requirements for the Pennsylvania Railroad Co., for itself and all other companies allied in interest, thereby enabling the subsidiary companies to derive the benefit of lower prices than could be obtained upon the relatively smaller quantity needed for each individual organization, and the same advantage applies to material manufactured at the shops where production in large quantities reduces costs to a minimum, while the cost to purchase in small quantities would be excessive in comparison. Consequently, it would be a decided disadvantage, owing to increased cost, also delays in providing the material for operating facilities, to be obliged to conform to the requirements of section 10 of the Clayton Act, making separate contracts or arrangements for each subsidiary railroad, involving needless multiplication of work and consequent expense without any compensatory returns.

In view of our intercorporate relations it would be a great disadvantage to disturb the practice and methods followed in conducting transactions for supplying material to affiliated companies and arranging for proper control of same, as described above, as the vast amount of detail necessary in conforming to the requirements of the law before the purchase of material could be made, together with the variety and uncertainty of needs from time to time, would prove a serious menace to maintaining intelligently the supplying of material necessary for providing efficient operating facilities.

Probably the most striking disadvantage is the difficulty under rules requiring so much formality to make adequate provision for the vast amount of material, consisting of practically all classes of commodities required for use daily in operating the railroad, owing to the wide fluctuations in the demands and the difficulty in foreseeing future needs with sufficient accuracy to insure ample stocks at all times when required, necessitating the purchasing and carrying of enormous stocks to insure against delay, and, incidentally, the consequent additional burden of increased unproductive investments as the only absolute safeguard against interruption of service.

I want also to read an extract from a letter from the New York Central:

The New York Central System is composed of a large number of separate companies, many of which are separately operated although under common control. For instance, among the companies separately operated are the following, of whose capital stocks the New York Central owns the percentages shown below:

<i>Percentage of capital stock owned by the New York Central.</i>	
	Per cent.
Michigan Central Railroad Co.	90
Pittsburgh & Lake Erie Railroad Co.	51
Cleveland, Cincinnati, Chicago & St. Louis Railway Co.	52
Lake Erie & Western Railroad Co.	51

While the boards of directors of these companies are not identical, a majority of the board in each case is the same. They all have the same president, treasurer, and secretary, and many of them have the same vice presidents. The New York Central has, from time to time, loaned moneys to some of these companies on collateral and has taken their securities, issued with the approval of the commissions having jurisdiction.

Great confusion and embarrassment will be caused if section 10 is allowed to go into effect. It is difficult to interpret and apply it, and apparently it is so broad as to prevent the continuation of practices which are of undoubted benefit to the companies and to the public. For instance, it is the practice of the different companies, included in the New York Central System, to purchase from each other surplus stocks of materials, that is to say, when any of the system lines is found to have stocks beyond its requirements for a period of six months, the surplus is transferred to some other system line not so well supplied. At the present time the Michigan Central finds itself with an excess supply of air-brake hose, and the New York Central proposes to purchase this excess substantially at the market price. Under the existing practice it is possible for the principal company in a system to buy supplies in larger quantities on behalf of itself and its associated companies and then to make distribution as the need for the different articles develops.

The New York Central owns all of the stock of the Clearfield Bituminous Coal Corporation, which operates mines in Pennsylvania, all of the coal taken from which is bought by the New York Central for use in its engines. On the board of the Clearfield company there are men who are also directors of the New York Central.

The New York State Realty & Terminal Co. owns properties within the Grand Central Terminal area in New York and elsewhere. All of its stock is owned by the New York Central, and it is recognized as being the New York Central's real estate company.

There is of necessity not only a very close relationship between the New York Central and these different companies which it controls, but also a considerable amount of dealings between it and the system lines and these controlled companies, such dealings being of a varied character.

While it may be entirely proper that the relations and dealings between these companies should be under the observation of the Interstate Commerce Commission and, so far as necessary, subject to its supervision, there does not seem to be a good reason for requiring them to have separate boards of directors or, if they do not, for subjecting them to the rule of competitive bidding in all their inter-company dealings.

There are also on our boards men who are directors of banks and of trust companies having large resources and to which we can go when we need money.

The transportation act now safeguards the public interest so far as it may be involved in the dual relations of directors, and that matter does not require to be further dealt with. It surely will not be in the public interest to require a strong director to retire from a railroad board because he is also a director of a bank and to fill the vacancy by the substitution of a man who, while he may have no outside interest, does not have the qualifications of the man who is

compelled to withdraw. The companies ought not to be required to elect whether they will cut themselves off from sources of money supply or will leave off their boards some of their strongest directors.

Now, the Atchison Co.'s line:

The Atchison parent company is the owner of all of the stock of the Gulf, Colorado & Santa Fe Railway Co., having a mileage of about 1,300 miles; the Panhandle & Santa Fe Railway Co., having a mileage of about 630 miles; the Rio Grande, El Paso & Santa Fe Railroad Co., having a mileage of about 20 miles; and the Grand Canyon Railway Co., having a mileage of about 64 miles.

These properties are operated absolutely as a system. Materials and supplies are purchased by the Atchison and billed to the other companies at cost to the Atchison, plus a transportation charge. The repair shops of these companies are so arranged as to take care of the repairs of equipment at cost, whether for repair of equipment owned by the Atchison or its subsidiaries.

None of the subsidiaries of the Atchison company have the necessary credit to acquire the equipment necessary to be used in the operation of the lines of such subsidiaries. The Atchison company buys this equipment and supplies it to the subsidiary lines, the expense of maintenance being apportioned upon the basis of mileage run of the equipment on the several lines. The Atchison also computes the cost of equipment and charges the subsidiary lines such proportion of 6 per cent of the cost of equipment as the mileage run by the equipment on each of the subsidiary lines bears to the total mileage made by such equipment.

The administration of these companies is so intimate that it would enormously impair the efficiency of operation, increase the cost of operation, require the rearrangement of shop facilities, and seriously embarrass the subsidiary companies in the matter of locomotives, passenger and freight cars.

I will not undertake to go into further detail, but the application of the Clayton Act to the dealings between the Atchison and subsidiary corporations would be so destructive to the interests of both the public and the Atchison stockholders that it is inconceivable to me that if Congress understands its actual effect it will permit such law to become effective.

The Atchison letter is supplemented by the following excerpt from a telegram:

Through trains are operated as between Atchison and all subsidiaries, and there are innumerable companies operating officers and employees beginning with the president and extending down to brakemen and trainmen on the trains and maintenance and railroad track repair, maintenance and car repair employees.

The following telegram from the Erie:

NEW YORK, N. Y., December 13, 1920.

Answering your wire 11th requesting statement in support of House postponement bill efforts to apply section 30, Clayton Act, necessarily suspended during Federal control. Difficult to do so during brief interval, since with so many other critical readjustment features pending. Chief difficulty with applying section 10 is grave uncertainties of its terms. It is capable of being construed to apply to agreement between jointly owned railroad properties, separately operated to comply with State laws affecting purchase of supplies, construction, and maintenance; to agreement between carriers of between carriers or public service companies, for joint trackage, joint operating, and other joint facilities involving construction and maintenance; to contracts for purchase of fuel coal from companies controlled by sole or substantially sole stock ownership whose entire or substantially entire output the controlling carriers consumes. This relation is employed quite generally by carriers to insure a fuel supply against transportation strike or other emergency where the lack of an immediately available fuel supply might otherwise paralyze transportation facilities. If section 10, Clayton Act, applies to such situations, some time will be required to determine that question, and, if so, make necessary changes in such important, extensive, and complicated relations to avoid violation bill already pending in Congress to amend Clayton Act. To relieve this confusion, effective date of section 10 should therefore be postponed to enable the section to be amended or its meaning determined and resulting readjustment of important relations accomplished, if necessary.

Now, I have here several similar letters from other roads.

The CHAIRMAN. Insert those in the hearing.

Mr. THOM. Yes, sir. I have similar letters from the Erie and other companies, but that will be illustrative. I ask you gentlemen, because I am most anxious that this bill shall be reported and get on your calendar before the 1st of January in order to prevent a most serious embarrassment, I ask you if there is not enough in this subject to justify you to give it your most serious study before you put the system in force, and I ask you, if you think I have demonstrated that much, that you report the bill so that we may have it in effect before the 1st of January.

The CHAIRMAN. Is there anyone else who desires to be heard?

Mr. Robinson arose.

**STATEMENT OF MR. BIRD M. ROBINSON, PRESIDENT OF THE
AMERICAN SHORT LINE RAILROAD ASSOCIATION.**

Mr. ROBINSON. Mr. Chairman and gentlemen, this committee and Congress have been exceedingly considerate of the short-line railroads in the past. Unfortunately, the acts of Congress, the two acts that you gentlemen prepared and approved have been so construed, and in some instances so misconstrued, that the short lines have received very little of the benefit you intended should be conferred upon them. This matter of section 10 of the Clayton Act is of special interest to the short-line railroads. As a rule, they were built by the leading, most influential, and wealthy citizens in their respective communities. As a rule, the lines themselves are very poor, hence they must rely upon the men who build them, for support during such periods as they have been passing through in the last three years. If section 10 of that act goes into effect on the 1st of January, it will immediately cut off the only source of supplies that many of them have. Very few of them have sufficient credit to enable them to advertise and obtain supplies through bids, because the bidders will fear that they won't get their pay, and if they do bid they will materially increase the price demanded, because of the doubtful credit.

Many of the persons interested in the short lines are interested in mines and lumber plants and all kinds of enterprises on such lines. They must be permitted to supply these roads, at least until their credit shall have been restored, otherwise many of such roads will be compelled to discontinue operation. As these men are the principal owners of such roads, it is not very likely that they will attempt to charge very high prices, because there would be no advantage in so doing.

I will take the liberty of referring to one road of which Mr. Jones, a member of this committee, is familiar. I refer to a short line in western New York; certain individuals built the road; they operate it and maintain it, and I know the credit of the road itself is not sufficient to enable it to buy oil and the things he has referred to in an emergency. I know and he knows that the owners are amply able to take care of the situation if they are permitted to do it. They are able to furnish the transportation needed by their community, but if this act goes into effect, and they are going to be subjected to a fine of \$25,000 or some other sum it will be disastrous. I think Mr. Jones will bear me out in that statement.

Mr. JONES. The Government can have it for the fine if they put \$25,000 on it.

Mr. ROBINSON. It will be \$25,000 or some other heavy penalty each time there is any violation of the act.

Now, gentlemen, I promised to limit myself to five minutes. We earnestly ask this committee report the bill under consideration and aid Congress in granting the necessary extension, and we promise to bring before you in due time good and sufficient reasons to justify an amendment to the act and sustain you in having made the extension. I thank you.

LETTERS SUBMITTED.

The CHAIRMAN. I wish to have inserted in the record this letter from Commissioner McChord, of the Interstate Commerce Commission, in regard to the attitude of the commission on the pending bill. It closes with the statement:

The committee has no objection to offer toward the extension.

The letter follows:

INTERSTATE COMMERCE COMMISSION,
Washington, December 13, 1920.

HON. JOHN J. ESCH,
Chairman Committee on Interstate and Foreign Commerce,
House of Representatives, Washington, D. C.

MY DEAR MR. ESCH: The legislative committee of the commission has carefully considered bill H. R. 14674 to amend section 501 of the transportation act, 1920, so as to extend the effective date of section 10 of the Clayton Antitrust Act to January 1, 1922, which was submitted with your letter of December 11, 1920, to the chairman of this commission.

I am authorized to say on behalf of the legislative committee that in the light of the difficulties encountered in the application of section 10, and of our understanding that because of changed conditions counsel for the carriers are considering proposals for other legislation in this regard which would seem better adapted to present need, the committee has no objection to offer to the proposed extension.

Very truly, yours,

CHAS. C. MCCORD, Commissioner.

I also wish to have included in the record a letter sent me by Chairman Volstead, of the Judiciary Committee, inclosing a letter received by Congressman Campbell, of Kansas, from Mr. Blair, general attorney of a railroad, calling attention to the need of this legislation:

HOUSE OF REPRESENTATIVES,
Washington, D. C., December 10, 1920.

HON. J. J. ESCH,
Chairman Interstate and Foreign Commerce Committee,
House of Representatives, Washington, D. C.

DEAR MR. ESCH: I notice that you have introduced a bill, H. R. 14674, "To amend section 501 of the transportation act of 1920," and which has been referred to your committee. I have received several communications regarding this matter, and I am taking the liberty to refer them to you for the information of the committee.

Very truly, yours,

A. J. VOLSTEAD.

UNION PACIFIC RAILROAD CO.,
LAW DEPARTMENT, KANSAS AND MISSOURI,
Topeka, Kans., November 22, 1920.

HON. PHILIP P. CAMPBELL,
Representative in Congress, Pittsburg, Kans.

DEAR SIR: I desire to call your attention to section 10 of the Clayton Act (38 Stat. L., ch. 323, p. 730), the effective date on which has been extended from time to time, but which will become operative on January 1, 1921, if no further extension is provided for.

20 AMENDMENT OF SECTION 501 OF TRANSPORTATION ACT.

You will recall that the last extension was embodied in section 501 of the transportation act of 1920. This extension was granted with the expectation that before January 1, 1921, Congress would be able to give the section consideration, with a view to its amendment. An appropriate bill for that purpose was prepared, but before being introduced was referred to the Interstate Commerce Commission for criticism. Owing to the vast amount of work thrown on that commission by the new law, it was unable to report on the bill before the adjournment of Congress. Another effort will be made upon the convening of Congress in December to amend the section, but the time intervening before it becomes effective is so short that a further extension of its effective date may be necessary in order to give sufficient time for the proper consideration of the proposed amendments.

This law, in a number of respects, will be unnecessarily burdensome, and I think this fact will be apparent to you upon a reading of the section, and of the amendments proposed. A copy of the section is inclosed.

The amendments which are deemed necessary are substantially as follows. (I state them very briefly.)

1. To exclude from the operation of the section dealings between affiliated companies which clearly were not within the evil at which the law was aimed.

2. To authorize the Interstate Commerce Commission to construe the law in certain particulars; for example, if a director of a railroad company desiring to buy rail from a subsidiary of the United States Steel Corporation owns 100 shares of stock in the United States Steel Corporation, is this a "substantial interest" on his part in the Steel Corporation subsidiary within the meaning of the section as it now stands?

3. To exclude from the operation of the section articles of a character by reason of patent or otherwise which can be obtained only from a single dealer so that no competition is possible.

4. To allow the railroads honest business discretion in determining what bid in competitive bidding is the most favorable.

5. To sanction further negotiations between the railroad with one or more of the bidders with a view to securing a further reduction of their bids.

I hope you will be able to give these suggested amendments careful consideration and if you think they should be made that you will use your best efforts to see that they are adopted before the law becomes operative on January 1, 1921, as provided in section 501 of the transportation act. If the law can not be amended before its present effective date, then it would seem that further extension should be provided for so that the objections offered by the railroads may be fully considered.

I will send a duplicate of this letter to your Washington address.

Very respectfully,

R. W. BLAIR.

I also wish to have inserted this letter from Commissioner Hall of the Interstate Commerce Commission:

INTERSTATE COMMERCE COMMISSION,
Washington, December 13, 1920.

Hon. JOHN J. ESCH,

Chairman Committee on Interstate and Foreign Commerce,
House of Representatives, Washington, D. C.

MY DEAR MR. ESCH: The legislative committee of the commission has carefully considered bill H. R. 14674, to amend section 501 of the transportation act, 1920, so as to extend the effective date of section 10 of the Clayton Antitrust Act to January 1, 1922, which was submitted with your letter of December 11, 1920, to the chairman of this commission.

I am authorized to say on behalf of the legislative committee that in the light of the difficulties encountered in the application of section 10 and of our understanding that because of changed conditions counsel for the carriers are considering proposals for other legislation in this regard which would seem better adapted to present needs the committee has no objection to offer to the proposed extension.

Very truly, yours,

HENRY C. HALL, Commissioner.

Thereupon at 12 m. the hearing was concluded and the committee went into executive session.

X

**END OF
TITLE**